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JERSEY CITY
COMMUNITY RENEWAL PROGRAM

COMMERCIAL LAND USE
BLIGHT CRITERIA GUIDE



LARRY SMITH & COMPANY




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BLIGHT CRITERIA GUIDE

Prepared for
Jersey City Redevelopment Agency
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TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	i
SECTION I - Economic Value in Commercial Property	1
SECTION II - Economic Obsolescence in Commercial Property	6
SECTION III - Action at the CRP Level	12
SECTION IV - Action at the Project Level	15
APPENDIX - Rating System for 1961 Commercial/Industrial Survey by New Haven Redevelopment Agency	A-1

INTRODUCTION

The purpose of this report is to provide a guide outline on the economics of different kinds of commercial buildings, their probable economic life, their locational problems or advantages, and related factors. The establishment of such a guide has a two-fold purpose.

1. To aid the Jersey City Redevelopment Agency staff and Community Renewal Program (CRP) consultants in identifying and classifying commercial space in terms of relative deterioration, blight or blighting conditions; and
2. To provide assistance to the urban renewal staff at the project level in determining the feasibility and desirability of taking action to prevent or correct economic obsolescence.

Since two of the primary objectives of an urban renewal program are to 1) protect and improve the tax base, and 2) to upgrade or "revitalize" the physical facilities under the city's jurisdiction, it is necessary to identify, and to the extent possible, correct those factors contributing to or causing physical deterioration.

At the CRP level, one of the specific tasks confronting the Jersey City Redevelopment Agency staff and its consultants is the identification of deteriorating commercial structures; and once identified, the establishment of a program of urban renewal action to correct the identified deficiencies. It is the purpose of this report to provide the economic basis for such an identification and action program.

For purposes of this report, the term commercial property will include all urban land uses except residential, institutional, industrial and governmental. The term "commercial" will be used in a general or generic sense with specific comments on such uses as retail, general office space and business and professional services where appropriate.

It must be recognized, of course, that in the broadest sense rental residential properties are also commercial in nature. The single factor which distinguishes these types of properties from the ownership in single family residential property is that ownership in commercial real estate is generally synonymous with investment. Unlike owner-occupied residential properties which are held for consumption, commercial properties are generally held either as an investment in and of themselves, or as a factor in a specific commercial enterprise such as retailing or manufacturing. Consequently, the maintenance level of such commercial property is a direct function of either the

income produced by the property for an investor or the economic utility of structures held as a factor in a specific commercial enterprise. This is true regardless of whether consideration is being given to past maintenance levels, the possibility of immediate rehabilitation, or the opportunities for the long-run conservation of properties through continuing high levels of maintenance.

It should also be noted that even though the problem can be reduced to considerations of individual properties, it starts in an area of much broader scope including general economic trends and shifts, such as changes in the socio-economic characteristics of a trade area or a shift from rail and water to truck transportation. Therefore, the availability of a net income stream of sufficient size to warrant rehabilitation or conservation is dependent not only upon the physical characteristics and condition of the structure and the type of strength of the tenant, but also upon all those factors which are creating changing environments.

In undertaking this analysis, the report is divided into four sections:

Section I - Economic Value in Commercial Property contains a general discussion of those factors and forces acting on commercial property and which create, as it were, the value of the property.

Section II - Economic Obsolescence in Commercial Property discusses how changes in economic factors acting on an individual or group of commercial properties can lead to economic obsolescence.

Section III - Action at the CRP Level undertakes to provide a means of identifying areas within Jersey City subject to various stages of deterioration, as well as to provide a framework from within which a program can be developed for treating such deterioration at the project level.

Section IV - Action at the Project Level sets up a guide for evaluating individual structures and properties by the project staff at the project level.

With the exception of a rating system for commercial and industrial buildings prepared by the New Haven Redevelopment Agency (Appendix A) and the National Institute of Real Estate Brokers annual publication "Percentage Leases", the data used in the preparation of this study are from standard sources and the files of Larry Smith & Company.

SECTION I

ECONOMIC VALUE IN COMMERCIAL PROPERTY

Broadly speaking, economic obsolescence, which is frequently identified by physical deterioration, is generally found throughout an entire area rather than in individual isolated instances within a generally healthy area. Consequently, it follows that both the identification and treatment of the economic obsolescence of commercial properties should concentrate on the improvement of the economic environment and climate, and refrain from programs of rehabilitation or renewal of individual commercial properties when there is a reasonable chance that the factors causing the economic obsolescence of a single property can be alleviated by the improvement of the general conditions within its area of economic support. Where there are isolated instances of economic obsolescence or physical deterioration within otherwise healthy commercial areas, these can perhaps be readily treated through rehabilitation programs; however, in general it is found that physical deterioration and the spread of commercial blight is district-wide and is consequently more properly attacked through an analysis of the general economic factors and forces at work within the trading or support area.

The relative importance of the various forces acting on commercial property varies with the type of land use, its environment and geographical location. Furthermore, it should be emphasized that some economic factors apply primarily to the land while others determine the economic value of the structures occupied by commercial uses. The distinction between land use and structural utility as well as their interaction on economic value should be kept in mind throughout the following discussion.

The principal economic factors contributing to the value of commercial property can be divided into three major areas:

1. Location,
2. Structural function, and
3. Occupancy.

Each of these is discussed below.

Location

The unique location of each individual parcel of real estate is one of the major factors contributing to the value of the land itself and the improvement developed thereon. The fixed nature of a commercial real estate investment places heavy dependence by the owner or user on his neighborhood or surrounding environment and the

various economic forces it contains. These major economic forces include:

1. Population - Many types of commercial land use depend heavily on the number and composition of the surrounding population, whether as customers or employees. The sensitivity to surrounding population may be great or slight, depending on the type of land use and also may vary widely in geographic extent, again determined by the commercial activity. Examples would range from the dependence of a food retailing facility upon a population within a one or two mile radius, to commercial offices or manufacturing plants which may serve customers over a major region, all of the United States or the entire world. For each, the locational problems are different.
2. Transportation - The various modes of transportation available to a specific commercial property determine its effectiveness in serving its customers, accessibility to its workers, or economic contact with other commercial enterprises.
3. Relationship to Other Land Uses - Aside from the requirement of certain types of commercial property for contact with other commercial enterprises, in many instances the effectiveness of the commercial land use is heavily dependent on its location near complementary or similar uses. Examples here would be the need of many retail stores to be located in a retail concentration which affords the shopper a wide choice of merchandise.
4. Physical Environment - Many types of commercial enterprises, particularly retailing and office space, are sensitive to the physical appearance of their environments, as distinct from the types of surrounding land use.
5. Use Limitations - Through zoning, urban communities have imposed restrictions on the location of various commercial activities. Civic decisions to limit commercial development to certain specified areas may reinforce or work at cross-purposes with the other economic factors determining commercial location which have been mentioned above. The ability of zoning restrictions to reinforce or dislocate commercial development in relation to other economic factors make it a powerful tool which should be utilized in both alleviating existing and preventing future commercial obsolescence.

Structural Function

Most commercial enterprises require some type of physical shelter, from the modest requirements of an automobile repair shop or a junk yard to a high fashion women's apparel salon. Within this wide

range there are, on the one hand, many types of commercial structures which are adaptable to several uses and can be easily converted for use by numerous types of commercial enterprises. On the other hand, some commercial structures, such as motion picture theatres, can be converted to other uses only through great effort and at great expense. The major factors which determine the function and value of a commercial structure would include:

1. Size - The size of a commercial building in terms of both total area and the area available on each floor.
2. Building Arrangement - The physical arrangement of the structure and its height are also determinants of its economic value and utility. The layout of individual floors in a building may make it inefficient or costly for certain types of commercial operations and/or prevent its conversion to other commercial activities. While multi-story buildings are suitable for office space, business services and hotel facilities, retail uses, with the exception of department stores, are generally confined to only one or two levels.
3. Construction - The quality of construction may or may not be of importance to the commercial activity. While the cost of quality construction generally results in lower maintenance costs to the owner, it also generally results in higher rent costs to the user. However, the quality of construction is generally less important than the condition of the building and its appearance, as a factor in commercial operations.
4. Appearance - The appearance and attractiveness of a commercial building is quite important to certain types of retail stores, prestige office buildings and various other commercial activities. However, other commercial enterprises such as small repair shops, business services, and retail enterprises serving lower income groups are frequently not only indifferent to, but may be less successful in, attractive structures. The appearance of a building should not be confused with its basic construction or building condition, as quality commercial activities in attractive quarters may occupy a building which has basically poor construction or is in sub-standard condition.
5. Building Condition - As mentioned above, many commercial activities have little or no dependence upon basic building condition or type of structure, providing the building is functionally suitable and has an acceptable appearance. Building condition is, however, of importance to the municipality which is obliged to protect the health, safety and

welfare of the building's occupants and the community's citizens. Because of the indifference of some occupants to building condition, the natural forces of economic pressure cannot be expected to work as well in maintaining a commercial building's structural condition as they do in maintaining its outward appearance.

6. Amenities - The improvements or amenities supplied by the commercial structure are important as they relate to the demands of the user. Examples within recent years are basic improvements in lighting and the requirement for air-conditioning for many commercial uses.

Occupancy Cost

The occupancy cost of a given commercial property is largely determined by the natural market forces at work on both the land and the commercial structure and is, as a result, more complex than simply the rent paid by the building's tenant. Occupancy costs determine not only the types of commercial activities which can bid for the building but also include the funds which will be expended to maintain the structure's physical condition. Occupancy costs may be related not only to the individual commercial property but to the local and national real estate market. In general, occupancy costs may include:

1. Mortgage debt servicing
2. Return to equity
3. Management
4. Real Estate taxes
5. Insurance
6. Utilities
7. Maintenance

As can be seen, these different categories of operating costs originate from a number of sources and differ in terms of their applicability to any particular property by different ownership situations. For example, while real estate taxes, insurance, and utilities can usually be specifically identified on all properties, where owner-occupied premises are involved and all outstanding mortgage debt has been amortized there will be no identifiable mortgage debt servicing, return to equity, or management cost. Also, maintenance and other costs are generally quite difficult to identify except in situations where they are specifically budgeted. Therefore, except in organized real estate developments such as shopping centers or industrial parks, the structure of occupancy costs of each of the properties involved can differ widely and must be determined by a separate and systematic investigation.

It should also be noted that the majority of the operating costs are, particularly in a landlord-tenant situation, contractual in nature. The one which can be singled out as wholly variable at the discretion of the landlord is No. 7, Maintenance; and it is the level of maintenance which in large part determines whether or not a property will become subject to scrutiny for a possible urban renewal action. A property might, of course, be maintained at a high level if the landlord is willing to direct funds to that purpose perhaps at the sacrifice of a satisfactory return on his equity or if he is willing to forego remuneration for management services. In any event, such a diversion of funds necessitates a conscious decision on the part of the owner with respect to the long-run opportunities for the property. Where the owner anticipates that an unsatisfactory level of rent receipts can be corrected, the necessary steps with regard to maintenance or property upkeep can be expected to take place. However, where the property is located in a declining economic area, and where the landlord is competing with vacant properties for tenants, it can be expected that in order to minimize rent charges to prospective tenants, the level of maintenance will be allowed to slip. It might be again mentioned here that the factor which distinguishes commercial properties from owner-occupied residential properties is the investment motive involved in ownership which by definition implies the seeking of a satisfactory return on equity.

In instances involving landlord-tenant relationships, the tenant's occupancy costs are generally lumped together as one rent payment and can, therefore, be readily identified and, with the cooperation of the landlord, broken into basic categories for analysis. However, in instances involving occupancy by an owner-tenant, the process is more complex since the ownership of the real estate and its occupancy costs are intermingled with the operation of the owner's business. However, contractual payments such as mortgage debt servicing, real estate taxes, insurance, and utilities are readily identifiable; but occupancy costs associated with ownership itself (the return to equity and management) are frequently intermingled with the proceeds of the business and therefore cannot be readily broken out. As discussed above, it is in this area where the discretion of management is paramount regarding whether or not to undertake necessary repairs or maintenance. The manner in which the availability of such discretionary funds might be identified will be discussed in a later section of this report.

SECTION II

ECONOMIC OBSOLESCENCE IN COMMERCIAL PROPERTY

As discussed in Section I, the nature of commercial properties as either investments or as factors in production leads to their continuous evaluation by their owners or users regarding their economic functioning. The rent paid by the tenant and received by the landlord of commercial and industrial property (whether real or imputed)* is directly related to the income stream generated by the activity undertaken on the property.

In turn, the type of activity or use attracted to or maintained on a particular property is dependent largely upon the three factors discussed in the previous section: (1) the location of the property, (2) the structural utility of the improvement on the property, and (3) the cost of occupying the land and improvements.

This portion of the report will demonstrate how changes in the use controlling factors mentioned above create economic obsolescence.

In analyzing the problem of blight, the various types of commercial real estate users are classified into three specific categories relative to their locational criteria. These categories are: (1) location dependent users, (2) semi-location oriented users, and (3) location discretionary users.

Location Dependent Users

Location dependent users consist of primarily of such uses as retail and personal service facilities which are dependent upon pedestrian traffic for their business. The generation of this traffic is in itself dependent upon locational factors. Consequently, whenever one or more of the locational factors which originally created the economic value of a property changes the value is altered, at least for the existing use.

One of the predominant factors leading to a decline in the economic value of the particular location are changes in socio-economic characteristics of the surrounding population served by the location dependent facility.

*In leased properties, the cost of occupancy - the rent - is a contractual obligation which can be identified and is in that sense real. In owner-occupied properties and particularly in older structures in older areas, there is no identifiable rent and, therefore, the economic or rental value of the property must be imputed from general economic data in order to provide a basis for comparison.

For instance, a substantial decrease in population in the residential area served by a neighborhood retail complex would cause a decline in sales volumes. The more inefficient and marginal operations would be forced out of business, creating vacancies.

A second basic cause of economic obsolescence in location dependent uses may result from changes in the nature of the activity itself. For example, a single new major supermarket may render several small corner grocery stores economically obsolete. The introduction of a supermarket of approximately 15,000 square feet in a retail area creates a sales capacity* of close to \$2 million which did not previously exist. Because of the competitive advantage which modern new facilities such as supermarkets hold over older existing facilities in terms of both inventory and price, a transfer of sales from older food markets to the new development occurs - resulting in a market overbuilt in relation to its trade area population.

A third major factor contributing to economic obsolescence is the physical utility of a property containing a location dependent use. For example, the development of modern retailing shopping centers with adequate off-street parking creates a far more attractive place to shop than do free-standing or strip facilities with limited parking on congested streets. Consequently, the small strip facilities are quite vulnerable to new center type developments.

It is, then, primarily one or a combination of these three forces discussed above which create economic obsolescence in physical facilities containing location dependent uses. In general terms, the very nature of the problem to economic obsolescence have the same result, a reduction in the sales volumes available to all such facilities and, therefore, in the amount of rent which can be paid by such facilities.

Whether a facility continues to operate at a given location under such declining sales volume opportunities is often dependent upon the willingness of the owner of the structure to accept a reduced rent. Where such is the case, it results naturally in a reduced income to the property owner which, for reasons cited in the previous section, commonly results in a cutback in funds spent for maintenance. Over time, deterioration in the physical structure itself will set in.

Any efforts undertaken by a city to revitalize a particular commercial area given over predominantly to location dependent uses must be directed toward the same goal - increasing the sale volumes of existing facilities. Where the obsolescence is caused by a decline in the

*Sales capacity refers to the normal or average sales potential of a given type of store to do a specific volume of business under conditions of average merchandising. The use of the term does not connote a physical or volume limitation on the ability of a store to do business.

trade area's population, the city might attempt to create a set of circumstances which will enable the population densities in the trade area serving the specific commercial facilities to return to their peak levels under which the existing space was developed. In general, however, the city can, through the urban renewal process, reduce the total amount of retail space to that which would be warranted by the population of the trade area which could normally be expected to be served by such facilities. The city can also work toward the elimination of environmental factors such as the absence of off-street parking. The extent of clearance required in any given area must, of course, be determined on the basis of a specific survey of market opportunities at the project level.

Semi-Location Oriented Users

Semi-location oriented users are those such as office buildings, transient residential facilities and amusement and recreational facilities which might operate successfully within a given two or three block radius of a single location.

Changes in locational factors which might tend to result in deterioration of such uses would evolve around the deterioration of a general neighborhood. Most semi-location oriented uses are prestige oriented. Offices and motels fall into this group. Any physical decline in the area surrounding the facility would tend to detract from its desirability and, therefore, effect the ease of obtaining tenants or guests. In addition, changes in the transportation system serving the area can contribute toward the economic obsolescence of particular uses.

The greatest cause of economic obsolescence in semi-location oriented facilities is brought about by technological changes which affect the functional utility of the structure containing the use. Obsolescence in the office and hotel industries can often be attributed to the failure or inability of owners to incorporate, on a continuing basis, technological changes in these industries as they occur. Consequently, a new office development which contains all the latest technical innovations and improvements such as parking, air conditioning, automatic elevator systems, etc., has a competitive advantage over older obsolete space even at the higher unit rent levels which are required by the new construction. Over time, the combination of more attractive appearance and the amenities offered in newer office buildings tends to reduce the occupancy level of the older more obsolete structures. This process, in turn, reduces the flow of income to the owner who, to maintain his profit margin in the face of this reduced income, will cut back on those expenses over which he has a certain degree of control; that is, maintenance funds. Consequently, the physical structure will deteriorate until such time as the value of the land warrants the demolition and development of a new structure.

Where, however, changes in locational factors have brought about the physical decline of an entire neighborhood, it is unlikely that private redevelopment will take place unassisted. A declining neighborhood cannot be made economically healthy by the development of a single new building and because of the decline in property values, it is virtually impossible to convince enough owners in the area to redevelop.

Location Discretionary Users

All other commercial and industrial facilities not discussed above can be categorized as location discretionary users. In this category fall such diverse users as government functions, educational and cultural facilities, headquarters operations of private corporations and public utilities, multi-family residential developments, medical-dental facilities, and most importantly, manufacturing and wholesaling operators.

Such uses are considered location discretionary because of their flexibility in choosing a site location. A manufacturing firm, for example, may have a specific requirement in terms of a location near highway or rail access or availability of water, etc. Nonetheless, his alternatives regarding a location are diverse not only within a given city, but also within a region.

One of the predominant factors contributing to the value of any particular piece of real estate and, therefore, its level of maintenance, is its structural utility as it relates to either its physical characteristics or functional layout. The physical utility is affected by such factors as original construction, remodeling, present condition and such other factors as availability of parking, off-street loading docks, etc.

Virtually all new construction takes place with the needs of a specific user or type of user in mind. New manufacturing facilities and other types of structures which require unique layouts are usually constructed subsequent to a contractual agreement with the tenant.

Such structures as these become economically obsolete when their physical characteristics or functional layouts no longer serve the uses for which they were developed. This may come about through technological changes in a particular industry or through changes in manufacturing in general. Over the past decade manufacturing firms tend to require one of horizontal type space as opposed to the multi-floor loft type structures developed since the turn of the century. Over time, the abilities industrial buildings to serve the function for which they were originally built tend to diminish and the original users seek other space which is more appropriate to its existing needs. Consequently, physical structures of the various types which are built to serve specific functions are placed on the open market.

Obviously, a change in use is required because the same factors which induced the original tenant to vacate mitigate against a similar type user moving in. A change in use without major rehabilitation is generally from a higher to a lower category (in rent paying ability) and consequently, can be considered as a warning sign of economic obsolescence and impending physical deterioration.

Assuming, of course, that the structure vacated is basically sound, it could probably be converted to a number of other uses. However, such uses commonly generate insufficient income to pay but a fraction of the rent paid by the vacated business.

There are, of course, large numbers of users of commercial space with rent paying propensity between that required by new construction and that which would be paid for the use of physical structure purely for storage purposes. The amount of rent which these potential users are willing and able to pay will vary but, in general, can be considered to be in proportion to the degree to which the physical structure must meet a potential user's specifications. For example, a user with no locational or functional requirements other than for a given amount of space, has a wide range of alternatives available to him and will, therefore, seek space at the lowest possible cost. As a potential user's locational and functional requirements increase, the space available within a given point in time which fit or come close to approximating the potential user's requirement decrease thereby reducing the alternatives available and resulting in a user who is willing and able to pay somewhat higher rents.

Once commercial space is vacated, the owner often times fails to realize that the same factors which influenced the former tenant to vacate the property reduces the possibility of obtaining a new tenant at relatively the same rent levels without major rehabilitation.

In turn, the ability of an owner to rehabilitate a structure no longer useful for the purposes for which it was built because of either locational or functional changes is generally faced with a tax assessment which does not recognize the obsolete characteristics of the property. Thus, the owner holds the property in hopes of obtaining a tenant who will pay the rent to which the owner is accustomed to getting. While seeking such a tenant, the structure remains vacant or is put to a much lower use on an interim basis. In either case, return on the property is insufficient to maintain the existing structural condition much less create a cash flow sufficient to make the physical changes necessary to attract a user with higher rent paying capacity.

In summary, then, the major factors contributing to economic obsolescence in commercial structures are:

1. Changes in locational factors, including the operation of the activity;
2. Changes in the functional requirements of commercial uses including physical characteristics or functional layout; and,
3. Occupancy costs.

SECTION III

ACTION AT THE CRP LEVEL

This portion of the blight criteria guide outlines those factors which can be used at the CRP level to identify economic obsolescence in commercial property. While the causes of economic obsolescence in commercial property are complex, the symptoms of economic obsolescence in these types of property are, generally speaking, readily recognizable. The most important of these symptoms are:

1. Vacancies,
2. Low standard of maintenance,
3. Use conversions, and
4. Age

The usefulness of these symptoms as reliable indicators of economic obsolescence in commercial properties is treated in the following discussion.

Economic Obsolescence in Commercial Property

Of the six symptoms mentioned above as being present in areas experiencing economic obsolescence, only one, the vacancy level, is consistently reliable as an indicator of economic obsolescence in commercial properties. Regardless of the area under consideration, an abnormally high rate of vacancies in a given area (say, more than 5%-7% of the total) is a certain indicator of economic dislocation either for the community as a whole or for the individual commercial complex.

It should be noted here that new facilities require time to achieve their maximum potential and, therefore, should be excluded from any computation of an area's vacancy rate for a particular type of facility. Where, however, such new space has been on the market for an exceptionally long period of time, say, a year or more, or where such new space might have been leased but shortly thereafter vacated, it should be included in the area's overall vacancy rate.

The extent to which commercial vacancies are found within a city also provides an indication as to the cause of the economic obsolescence. A high average vacancy level in the total community may indicate depressed economic conditions or an over-supply of commercial space, or both. However, a high vacancy level in specific complexes, which substantially exceeds that of the entire community, is certainly an indicator of economic obsolescence limited to the complex itself.

It is, therefore, important that the vacancy symptom be evaluated against the total community and its economic condition before any

firm conclusions are drawn as to the relative health or economic obsolescence of individual commercial areas.

Some, or all, of the other symptoms of economic obsolescence listed above will be found in areas experiencing economic obsolescence. However, as will be pointed out below, only vacancies represent a consistently reliable indicator in pointing out commercial property subject to economic obsolescence.

Substandard maintenance, for example, may indicate that rent levels have fallen to the point where the owner cuts back on maintenance to derive adequate return from the property. It must, however, be remembered that a relatively long period of time must pass without structural maintenance before physical deterioration becomes apparent. Thus, it is quite possible for abnormally high vacancies to appear in a given area with little or no obvious signs of structural deterioration.

Land coverage and floor area ratios are primarily a function of zoning and building regulations and, therefore, not necessarily indicative of economic obsolescence in commercial property. Of course, where predetermined standards can be established for commercial uses by areas of the city, then, certainly it is possible to measure the degree to which each commercial use within the area exceeds or falls below those standards. Unfortunately, this type of data would not necessarily be an indicator of economic obsolescence, but merely an indication as to the extent individual commercial properties deviate from established standards.

Use conversions work two ways. A conversion from a lower to a higher, more desirable use due to improvements in the economic conditions or environment in an area is not, of course, a symptom of economic obsolescence, but the reverse. The more common conversion is, of course, from a higher to a lower use which is unsuitable to the structure itself or to the surrounding environment, such as the use of obsolete retail stores for dwelling units.

Because conversion is one of the major economic alternatives available to a property owner and allows him greater flexibility in coping with his environment, conversions should be analyzed with care even when apparently compatible with the surrounding environment. Since conversions may result in a more proper use under changed economic circumstances, conversions are, therefore, an unreliable indicator of economic obsolescence unless each individual case is analyzed separately.

Age in commercial property is of little value as an indicator of economic obsolescence. A retailer, for example, might continue to occupy quite old structures in the central business district while new

space might be either so located or so designed as to be economically unattractive. In the economic sense, age can be deceiving and, therefore, its use as an indicator is limited unless each individual structure and situation is analyzed separately.

Summary of Identification Factors

In summary, then, at the CRP level commercial blight (or economic obsolescence) can be most readily and effectively delineated by vacancy rates.

In addition to providing absolute data concerning economic obsolescence in commercial property throughout the city, the above described identification systems will provide for establishment of a set of priorities in terms of treatment of economic obsolescence in commercial properties.

The delineation of project areas on the basis of a blight identification survey will, of course, be a relatively simple matter. The types of treatment which might be necessary will require a detailed analysis at the project level. There are, however, certain steps which can be taken at the CRP level to help alleviate and prevent structural deterioration due to economic obsolescence. Some of the more important steps which might be taken are:

1. Review and revise, where necessary, zoning regulations to prevent the establishment of non-conforming uses.
2. Review the city's street patterns in relation to its commercial areas to improve, to the greatest extent possible, access from these commercial areas to the major arterials serving the region.
3. Coordinating parking facilities in the city with the needs of the major commercial clusters. Where such parking is obviously in short supply, some efforts can be made at the CRP level in coordination with highway authorities and local traffic agencies to alleviate the major problems.

Of these suggested courses of action at the CRP level, the identification of blighted areas is by far the most important and has been treated in considerably more detail.

SECTION IV

ACTION AT THE PROJECT LEVEL

Data to be gathered in the field with respect to the total Community Renewal Program will, when summarized, indicate the specific areas in which any one or all of these symptoms appear. Therefore, the process of area identification is an integral part of the entire Community Renewal Program and can be conducted as a continuing part of that program. However, once areas containing evidence of the symptoms of impending economic obsolescence are identified, there remains the task of further examination and prescribing remedial action.

Retail Properties

As already indicated in Section I, there are eight general categories of occupancy costs which appear in different combinations for all properties. It was also identified that, of the eight categories, the two which have the greatest flexibility in terms of management decision are the interchange of funds between a return to equity (proprietary profits) and maintenance. It has also been indicated above that, in circumstances where the physical productivity of the property is low, the level of maintenance tends to suffer. It has also been indicated above that the physical deterioration of an entire area is generally directly attributable to a downward adjustment in the economic base of the support area. Consequently, the low standard of maintenance leading to the outward physical deterioration of the area can, in most instances, be directly attributable to a set of economic circumstances which lie outside the control of any of the property owners. The property owners are, therefore, reacting to a situation rather than creating one.

In a situation where strong symptoms of economic obsolescence and physical deterioration are evidenced, the first problem of analysis is the determination of the causes for the apparent decline in economic opportunity. These can come from a number of factors, including:

1. A change in the characteristics of the population of the support area which might include:
 - a. The possibility of a lowering in density, or
 - b. A downward trend in the per capita and average family incomes of the area;
2. The introduction of additional competition of insufficient magnitude to cause a shift in trade area residents' shopping habits; and/or

3. Changes in transportation facilities.

Any one or all of these factors may contribute to the economic decline of an area. Therefore, before rehabilitation or renewal can be contemplated, the economic base against which such action would take place must be analyzed and understood. In the urban renewal process, this analysis could probably be undertaken either as a feasibility survey preceding the designation of a project area, or as a land utilization and marketability study following the identification of a project area. However, regardless of which procedure is adopted, the following steps would have to be taken to determine the broad area opportunities for facilities at the existing location, and to establish the opportunities for rehabilitation or renewal. The factors to be considered are:

1. The geographical area from within which the area under analysis draws the bulk of its support. This can be determined by customer location surveys conducted in the area.
2. Access within the established trade area, both in terms of the local arterial pattern and secondary road systems and public transportation if it is determined through prior examination that public transportation bears an important part of the total movement of shoppers in the area. The extent to which public and other types of transportation are used by the location's customers can be determined in conjunction with the customer location survey used to establish the trade area.
3. The number and socio-economic characteristics of the trade area population, including recent trends which might have influenced the change in level of commercial activity in the area. Since an area's population changes relatively slowly, data from the decennial census can be used.
4. The per capita expenditure pattern for the trade area inhabitants should be established for those types of retail facilities which would be suitable for the renewal area. Again, census data (the Census of Business) is the best source of information.
5. By combining the population and expenditure patterns, an estimate of total potential by retail categories can be established as a measure of total opportunity for all facilities.
6. Competitive facilities should be surveyed and analyzed to determine the amount of retail trade they can be

judged capable of doing in order to determine their impact as competition to a rehabilitated or renewed commercial area at the point of interest. The gross floor areas of competing facilities can be converted to annual volume estimates by applying volume conversion factors obtainable from published sources such as "Shopping Center Age". Care should be taken in the use of such data since it generally applied to newer facilities of one type, while competition in facilities is usually less productive on a square foot basis.

7. Based upon an evaluation of the total potential available and the effectiveness of existing and proposed competitive facilities, a determination can be made of the total opportunity for retail volume at the site under study.

Once estimates of the total volume opportunity have been established, the specific criteria which will effect the economic feasibility of rehabilitation or renewal can be collected and analyzed. The problem of renewal of a specific area can be approached in many ways; however, two are foremost. These are:

1. An analysis of the opportunities for total clearance and the development of new facilities, presumably under the development of a single entrepreneur; or
2. The rehabilitation of individual properties within the project area.

The development of new facilities depends to a large extent upon attracting a developer with sufficient skills to create a successful shopping complex. In an older retail area, substantial clearance and new construction can have varied effects upon rehabilitation opportunities ranging from destroying all such possibilities to making the rehabilitation of individual properties economically feasible.

Since rehabilitation involves working with existing properties and, therefore, necessitates individual investment decisions by individual owners, the analysis must proceed on a property-by-property basis. However, of first importance is the establishment of the properties which are to receive attention for rehabilitation. In this respect, it is more important to identify the total area within which rehabilitation is to take place than to single out individual properties for special consideration since it is generally supposed that in order for a rehabilitation program to be effective, it must include, in addition to the private rehabilitation of private properties, public investment in public facilities such as additional parking facilities and improvements in the local street pattern. Neither of

these two activities can be meaningfully carried forward unless the area of rehabilitation is positively identified at the outset.

The process of identifying the area of rehabilitation starts with the determination of the total opportunity available on a store type category basis. In general, the major retail store categories identified in the Census of Business-Retail Trade are sufficient for this purpose, provided it is recognized that the historic distinction between retail type categories is gradually breaking down through present trends in retailing.

However, the determination of the area of rehabilitation can best be accomplished by a thorough understanding of the economic structure of the district rather than through the blanket application of standard volume criteria established as a standard for evaluating the opportunities for new construction. It is entirely feasible that a rehabilitation area could provide satisfactory real estate investment returns at much lower per square foot volume levels than would be required to support new construction in a suburban shopping center location. Therefore, a survey of the individual properties in the area of interest should be conducted as follows:

1. The volume of sales on an annual basis for at least the last year and preferably for the last five years should be determined.
2. For leased premises the rent terms of the lease should be identified.
3. From the landlord data should be gathered with respect to:
 - a. Levels of outstanding mortgages and annual service charges,
 - b. Real estate taxes,
 - c. Insurance,
 - d. Management costs, if any,
 - e. Utility costs if borne by the landlord, and
 - f. Any other recurring costs on the property.
4. For owner-tenanted properties the same data should be obtained.

This information, once gathered, should then be analyzed to determine the opportunity for rehabilitation. A suggested form for such an analysis is shown facing the following page.

SUGGESTED FORM FOR ANALYZING REHABILITATION OPPORTUNITIES

CASH FLOW ANALYSIS

	<u>Leased Property</u>		<u>Owner-Tenanted Property</u>	
	<u>A*</u>	<u>B*</u>	<u>A*</u>	<u>B*</u>
1. Gross Operating Level	\$	\$	\$	\$
2. Standard Percentage Rent Factor	-	%	%	%
3. Rental Income Available	\$	\$	\$	\$
4. Less Operating Costs	\$	\$	\$	\$
	<hr/>	<hr/>	<hr/>	<hr/>
5. Net Before Debt Service	\$	\$	\$	\$
6. Annual Debt Service	\$	\$	\$	\$
	<hr/>	<hr/>	<hr/>	<hr/>
7. Net Available to Equity	\$	\$	\$	\$

Operating Cost Summary

8. Real Estate Taxes	\$	\$	\$	\$
9. Insurance				
10. Management				
11. Other Costs				
	<hr/>	<hr/>	<hr/>	<hr/>
12. Total Operating Costs	\$	\$	\$	\$

Summary of Debt Service

13. Annual Debt Service	\$	\$	\$	\$
a. First Mortgage				
b. Other Obligations				
c. Other Obligations				
	<hr/>	<hr/>	<hr/>	<hr/>
14. Total Debt Service	\$	\$	\$	\$

*A-Under present circumstances.

B-Under rehabilitation volume opportunities.

It will be noted that there are four columns of data to be entered in the form, including "A" and "B" columns under the categories of Leased Property and Owner-Tenanted Property. The "A" column under each is a survey of past experience while the data to be entered under column "B" in each instance is a prognostication of future opportunities under a rehabilitation program.

1. Gross Operating Levels

Gross operating levels under column "A" would be as reported by the individual tenants. These should reflect a five-year average while taking into consideration any trends which might be evident from the five-year data. Under column "B" the gross operating level would be a reflection of the total opportunity available to the area against considerations involving the percentage of total floor area in the category occupied by the tenant in question, the location of the establishment, and other factors which might influence the level of retail sales. Insofar as possible, consideration must also be given to the effect rehabilitation might have upon the operating cost structure. Rehabilitation might lead to reassessment and even higher taxes. While this might be a real problem, there would be offsetting factors. For example, an upgrading of the property might cut fuel bills to some substantial degree.

2. Standard Percentage Rent Factors

The percentage rent factors are obtainable from at least two published sources. These are: Percentage Leases, published annually by the National Institute of Real Estate Brokers, and data published in trade journals such as Shopping Center Age. Percentage rent factors can also be calculated from the rents actually being collected in the area against the gross operating levels of the establishments. Such data would serve as a useful comparison, if not the primary guide.

3. Rental Income Available

Rental income can come from the tenants in leased properties or computed by using the percentage rent factors as applied to either actual or calculated volume levels.

4. Operating Costs

Operating costs are as summarized in the operating costs summary part of the table. This includes lines 8 and 11, or four entries including real estate taxes (which can be ascertained either from the owner or from the tax records), insurance (available from the owner), management costs (which in most instances would be non-existent, but if existent would be available from the owner or his representative), and other costs including special assessments and membership fees in owner's organizations which are necessary because of the location.

5. Annual Debt Service

Annual debt service is a combination of the factors included under line 13 of the table. These entries would include the current annual payments on first mortgage and other mortgage obligations, payments on notes encumbering the property or payments into reserve accounts intended to meet future liabilities yet to become due.

The determination of a net cash flow available to equity is, of course, only part of the total investment picture. Nevertheless, this type of analysis is important since in a situation where it is contemplated that additional investment will have to take place in the face of rehabilitation, the total cash flow available to equity should increase in columns "B" over columns "A". Otherwise, the test of the opportunity for private capital to enjoy a satisfactory return on additional investment would be missing.

The second test of the feasibility of rehabilitating individual properties is provided by the Capital Account Analysis suggested by the form on the following page. Here in line 1 the rental income available is the same as line 3 in the Cash Flow Analysis. In this case, however, the rental income available is reduced to a per square foot factor as is operating cost to providing net rental income per square foot of gross area. This sum is then capitalized to produce a total capitalized value on a square foot basis. From this is subtracted outstanding debts also reduced to a square foot basis. The remainder is the capitalized value above all outstanding debts which presumably is the per square foot equity value and the margin which the owner would be seeking to protect. While it is wholly unlikely that improvements in the property in excess of this amount could be anticipated, it is also unlikely that improvements up to this amount would be undertaken by the owner since such improvements would involve an upward adjustment in the debt service factor and would consequently draw down the net cash flow available to equity. Therefore, as a rough rule of thumb, it could be anticipated that the difference between columns "A" and "B" in the cash flow analysis would be the maximum annual debt service factor considered acceptable to most property owners.

At this point, note should be taken that much of the analysis hinges upon line 4 in the Capital Account Analysis, the capitalization rate employed. Therefore, extreme care must be taken to insure that a capitalization rate is used which wholly reflects the levels of risk and entrepreneurial expectation which would be consistent with the individual areas under consideration.

Since most of the areas which would be under consideration in analyses of this nature would be down-grading, it can be expected that the availability of funds for rehabilitation to private individuals would be very restricted, and then only available at exceedingly high interest

SUGGESTED FORM FOR ANALYZING REHABILITATION OPPORTUNITIES

CAPITAL ACCOUNT ANALYSIS

	<u>Leased Property</u>		<u>Owner-Tenanted Property</u>	
	<u>A</u>	<u>B</u>	<u>A</u>	<u>B</u>
1. Rental Income Available	\$	\$	\$	\$
2. Less Operating Costs	\$	\$	\$	\$
3. Net Rent	\$	\$	\$	\$
4. Capitalized @	%	%	%	%
5. Capitalized Value	\$	\$	\$	\$
6. Less Outstanding Debt	\$	\$	\$	\$
7. Remainder Available for Rehabilitation	\$	\$	\$	\$

rates. Also, there is a special risk factor associated with attempting to reverse economic trends in such an area which would also affect the capitalization rate which should be employed. In addition, it should be recognized that as the process of rehabilitation would involve the utilization of short term funds, the annual service charge against such loans would be quite high as a percentage of the total loan. For example, it would not be the least bit unusual to expect that annual debt service on a rehabilitation loan could amount to 20% to 25% of the total loan amount. A much lower debt service factor could, of course, be achieved through a special program.

The Service Industries

The service industries are commonly divided into two categories: personal services and business services. The former generally share facilities with retail establishments to the extent that the space occupied is customarily also space which has been designed for general retail use. There are, of course, exceptions to any general rule. For example, beauty shops are commonly found in second level space above the ground floor retail space in areas which otherwise would be more commonly associated with general office space uses. In any event, there is no facility of unique type devoted exclusively to personal services, and therefore, since they are most commonly identified with retail uses and since they are dependent upon the traffic generated by other commercial facilities for their business, they can be treated in much the same fashion as retail facilities in an analysis of the rehabilitation potential. Consequently, the same procedures recommended above for analysis of retail operations would be applicable to personal service industries with the exception that a prognosis of growth in operating levels is more difficult since detailed statistical data are not available in published form such as are available for retail trade.

Business services make up the second category of the general service industry. Here again, a wide range of space uses appears, none of which are directly associated with a specific type of space which would be identified as "service space" specifically. Business services occupy space which ranges in alternative uses from retailing through light industrial and general office. Again, as with the personal service industry, there is no means of forecasting gross operating levels of business services and, therefore, an analysis of rehabilitation opportunities for space occupied by these services must be limited to an interpretation of historic data collected from the operators themselves.

General Office Space

In the retail trade category in older areas, it can be expected that there will be a strong representation of owner-tenants. These owner-tenant classifications are far less frequent in office space. While

there has been a recent trend toward the development of owner-tenant buildings, these are not characteristically found in areas being considered for urban renewal treatment and consequently can generally be excluded from consideration in the analysis of the rehabilitation opportunity for such an area. More commonly, the office space users in areas which would be considered for rehabilitation treatment are small users of general office space who have available to them a wide range of alternative locations throughout a city.

The office space users, though customarily found in areas which are subject to rehabilitation treatment, commonly fall into two categories:

1. Those who are serving a relatively wide market involving either a whole district of a city, or the city in its entirety and, therefore, have available to them the opportunity to locate within a wide range of alternative locations, or
2. Office space users who are oriented toward a specific area and, therefore, will seek space within that area.

Regardless of their area orientation, the rehabilitation possibilities for general office space are dependent upon an analysis of the opportunities within the general prevailing rental income structure.

While it might be anticipated that some of the cost of space rehabilitation might be passed on directly to the tenants in the form of higher rents, it is far more likely that the cost of rehabilitation would be shared by tenants and landlords, and consequently, an analysis of the landlord's capacity to participate would be a necessary preliminary step in determining the extent to which rehabilitation might take place in commercial office space in areas being considered for renewal treatment. Again, the forms previously presented will provide a satisfactory means for gathering and analyzing the data necessary to the evaluation of the landlord's ability to participate in such a program.

Building Rating System

The New Haven, Connecticut Redevelopment Agency has developed a system for quantitatively rating commercial and industrial buildings. The system is useful as a guide in selecting specific properties within a given area for review. Such a system provides an additional measure for the extent of deterioration on a given property.

The criteria used in the rating system analyzes three facets of the property:

1. the building,
2. the lot, and
3. the environment.

The details of the penalty system of rating specific buildings are presented in the Appendix to this guide to blight determination.

APPENDIX

RATING SYSTEM FOR 1961 COMMERCIAL/INDUSTRIAL SURVEY BY NEW HAVEN REDEVELOPMENT AGENCY

"...One of the main objectives of this survey is to determine the relative blight conditions for commercial and industrial buildings. It was therefore essential to develop a blight rating system with explicit standards. The rating system developed deals with the issue on three separate levels, that of the building, that of the lot, and finally that of the environment. The following text gives in detail the factors that dictate the penalty, the source of information and the value in points for each penalty. Utmost attention has to be given for this part of the survey."

Building Rating

1. Age of Building

Penalty Scoring

Before 1906	4 points
1906 - 1929	2 points
1930 - 1945	1 point
After 1945	0 points
Maximum penalty is four points.	

2. Construction Type

Penalty Scoring

Fire Proof	0 points
Fire Resistant	1 point
Ordinary Construction	3 points
Frame Construction	6 points
Maximum penalty is six points.	

3. Building Condition

Penalty Scoring

No Repair	0 points
Minor Repair	1 point
Intermediate Repair	2 points
Extensive Repair	4 points
Infeasible Repair	6 points
Maximum penalty is six points.	

4. Floor Use

Penalty Scoring

Compatible	0 points
Residential & Commercial Uses	1 point
Residential & Industrial Uses	3 points

5. Floor Vacancy

Penalty Scoring

Ground Floor Vacancy

0 - 10%	0 points
10.1 - 50%	2 points
50.1 -100%	3 points

Upper Floor Vacancy

0 - 10%	0 points
10.1 - 70%	2 points
70.1 -100%	3 points

Maximum penalty scoring three points for each breakdown of a maximum total of six points.

Lot Rating

1. Lot Characteristics

Penalty Scoring

Poor Upkeep	1 point
Irregular Shape	1 point
Overcrowding	1 point
Non-Conforming Use	2 points
Noise From Lot	2 points
Air Pollution from Lot	2 points
Incompatible Use	2 points

Maximum penalty scoring is seven points.

2. Parking

Penalty Scoring

Space	1 point
Access	1 point
Location	1 point
Condition	1 point

Maximum penalty scoring is four points.

3. Loading

Penalty Scoring

Space	1 point
Access	1 point
Location	1 point
Condition	1 point
Maximum penalty scoring is four points.	

Environment Rating

1. Within Block

Penalty Scoring

Depth for Use	1 point
Platting	1 point
Maintenance	1 point
Circulation	2 points
Mixed Uses	3 points
Nuisance in Block	4 points
Condition of Residences	3 points
Maximum penalty scoring is fifteen points.	

2. Within Adjacent Block

Penalty Scoring

Nuisance	3 points
Conditions of Residences	2 points
Maximum penalty scoring is five points.	

